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Dame Meg Hillier
Chair
Public Accounts Committee
SW1A 0AA

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Dear Dame Meg,

PAC hearing on "Future of the Advanced Gas-Cooled Reactors"

Thank you for the opportunity to attend the Committee on 7 February on the revised decommissioning arrangements pertaining to the Advanced Gas-Cooled Reactors (AGRs).

During discussion the Department was asked to provide further explanation of the £5.6 billion contribution requested by the Nuclear Liabilities Fund (NLF), (approximately 80% of which results from changes in the tax rate assumptions used). The Committee noted that NLF's tax liabilities were £49 million in 2020/21, that an increase in corporation tax rates from 19% to 25% would add approximately £16m per annum to the annual corporation tax liability, and that these numbers would not support the quantum of contribution required.

The NLF is subject to corporation tax in the usual way for a UK company. Under current UK tax rules, it pays tax on the growth of its investments, made up of capital gains and investment income, though it generally expects to be exempt from UK tax on dividends.

By way of reminder, the NLF holds the bulk of its assets as cash deposited in the National Loans Fund (approx. £11.8bn). Its other assets are held in a Mixed Assets Portfolio (MAP), targeting longer term returns. The NLF meets its tax liabilities from its National Loans Fund deposits in the first instance.

The NLF undertakes an annual funding review of sufficiency projections across its full anticipated lifecycle of operation – out to 2125 (when the final liabilities are forecast to be extinguished). It projects its liabilities as they fall due and the growth of its investments. Its liabilities include decommissioning costs and taxation. Inputs to the projections include inflation, interest on the National Loans Fund deposits, target investment returns on the MAP and corporation tax rates.

For 2020/21, the NLF considered the impact of the increase in corporation tax from 19% to 25% and concluded that the tax rate should be the headline rate of 25% for the interest on the National Loans Fund deposits and a lower rate of 21% for the MAP. The lower rate for the MAP was calculated taking into account exempt UK dividend income and deferral of tax on capital gains until investments are realised.

The main driver of the 2020/21 contribution in respect of the increase in taxation rates is the assumed rate of return of 7.3% on the current MAP of ~£3 billion, compounded until 2125.

As taxation is payable on asset growth, the current annual tax liabilities cannot simply be multiplied. Over the next 20 or so years the MAP is projected to grow significantly whilst payments for decommissioning and other costs including taxation are paid out of the National Loans Fund. By the time the National Loans Fund deposits are fully extinguished (currently assumed to be in the mid-2040s), the MAP is forecast to have grown to c. £18 billion based on an expected return of 7.3%. This drives a significant increase in the tax payments made by the NLF.

In addition, this is around the time when the liability payments are projected to fall significantly as the AGR stations enter the ‘care and maintenance’ stage of decommissioning, allowing the MAP to continue to grow to meet the required payments for AGR final site clearance at the beginning of the next century. This results in the assets of the Fund being forecast to peak at over £200 billion with commensurate tax payments being made. Over the course of the life of the fund, the NLF forecasts that it will pay over £100 billion of tax[1].

The 2020/21 NLF annual sufficiency review identified a material shortfall that resulted in a request for a £5.6 billion contribution which if provided would be held in the National Loans Fund, until used to meet liabilities. The alternative to providing this contribution was NLF withdrawing £5.5 billion from its existing National Loans Fund deposit for more active investment in the MAP.

The Committee might also wish to note that there is no single discount rate used; the inputs to the sufficiency review that are noted above all have their own assumptions (e.g. inflation, interest rates, MAP returns) and are projected forward. The ‘top up’ that will be provided by Government is the contribution required to ensure the fund can meet the best available estimate of its liabilities out to 2125.

During the hearing I also pledged to come back to you jointly with HMT on wider investment strategy questions for the NLF, following future correspondence from the Committee. I look forward to providing this detail.

I trust this addresses the question raised by the Committee.

Sarah Munby

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[1] The numbers quoted are in the monetary amounts of the day rather than today’s monetary terms.